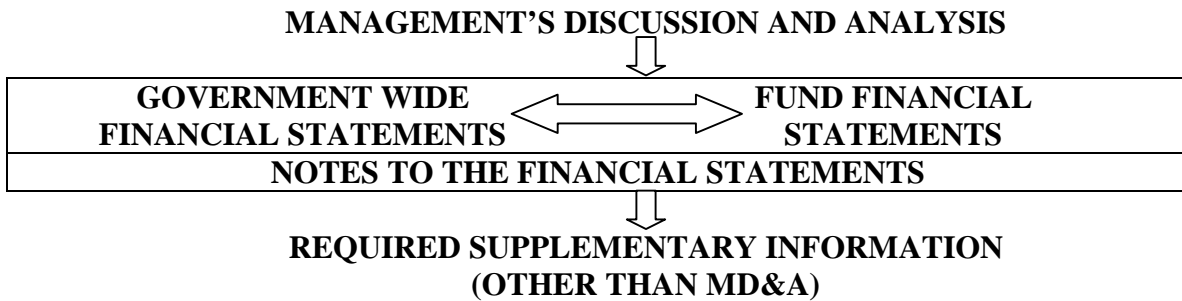


III. The Components of the Financial Statements

The components of the financial statements under GASB 34 are as follows:



Notice that the Letter of Transmittal and any statistics *are not* included in the “core” GPFS which are required under Statement 34. However, should your entity decide to produce a full CAFR, they are necessary information.

Components of Financial Statements Under Statement 34

<u>GPFS</u>	<u>CAFR</u>
Management’s Discussion and Analysis	Transmittal Letter
Government-wide Financial Statements	Management’s Discussion and Analysis
Fund Financial Statements	Government-wide Financial Statements
Notes to the Financial Statements	Fund Financial Statements
Required Supplementary Information (other than MD&A)	Notes to the Financial Statements
	Required Supplementary Information (other than MD&A)
	Statistics and Other Economic Data

For component units in the Commonwealth there will be minor changes in comparison to other types of governmental entities. For a discussion on the entity –wide financial statements, please feel free to review Statement 34, paragraphs 12 through 17 and 30 through 90.

a. Components of Financial Statements for Component Units

Per GASB statement 34, there are three required financial statements:

New Name	Old Name
Statement of Net Assets or Balance Sheet	Balance Sheet
Statement of Revenues, Expenses and Changes in Fund Net Assets	Statement of Revenues, Expenditures and Changes or – Statement of Changes in Fund Balances
Statement of Cash Flows	Statement of Cash Flows

b. Measurement and Focus of Revenues and Expenses

The focus and measurement of the revenues and expenses is the accrual basis of accounting. Revenues are recognized in the accounting period in which they are **earned and become measurable**. Expenses are recognized **in the period in which they are incurred, if measurable, including depreciation**.³

c. Statement of Revenues, Expenses and Changes in Net Assets

This statement is a combination of your current statement of revenues and expenditures and your entity's statement of changes in fund balances. It is the operating statement for business – type activities, (“BTAs.”) The BTA format is the format most parties in the Commonwealth and its auditors have proposed.⁴ Most Component Units in the Commonwealth operate consistently with the definition of a Special Purpose Government and engage only in Business type activities as defined under GASB Statement 34, paragraph 134. Furthermore, your entity is precluded from using the governmental format that the Commonwealth uses, **unless your entity has taxing authority**.

The format of the statement is as follows. Please use the following accounts to classify your financial information. **Please note that these items are for illustration only and are not authoritative.**

Operating Revenues

Charges for services (tolls, sales, fares, rents, fees, leases etc.)

Interest income **(if a lending entity)**⁵

Other operating income

Subtotal of Operating Revenues

Operating Expenses

Claims & Judgement expense

Cost of services and administration

Subtotal of Operating Expenses

Total Operating Income (Loss)

Non-operating revenues and expenses

COMMONWEALTH OPERATING APPROPRIATIONS

Gifts

Investment income (net of investment expense – unless material – then present as a separate line -) **Note – not if your entity is a lending entity.**

³ National Council on Governmental Accounting Statement 1 *Governmental Accounting and Financial Reporting Principles*. Principle 8b, paragraphs 57b and 60. March 1979.

⁴ Currently, the Massachusetts Technology Park Corporation has a portion of its activities that use the governmental basis of financial reporting under Paragraph 135 of Statement 34.

⁵ Would apply to entities such as the Massachusetts Water Pollution Abatement Trust. For these type of entities, **Interest Expense would be an operating expense as well. For normal bond interest to finance capital asset related debt, Interest Expense is non-operating.**

Interest on capital – asset related debt
Other non-operating revenues
Other non-operating expenses

Income before other revenues, expenses, gains, losses and transfers

CAPITAL (not operating) contributions, additions to permanent funds, special and extraordinary items and transfers

Commonwealth Capital appropriations
Capital grants and gifts
Extraordinary items, sales and transfers
Increase (decrease) in net assets

Net Assets – beginning of period

Net Assets – end of period

This is a model that is provided in GASB 34, paragraph 101. Should your entity have any other material reporting categories, please contact us for proper reporting. Pursuant to GASB 9, operating appropriations from a primary government are considered **non-capital financing** cash flows and corresponding revenues to the component unit.⁶ A more thorough discussion on appropriations is below.

d. Statement of Net Assets – the New Balance Sheet

Statements 34 and 35 set up a new form of the balance sheet called the **Statement of Net Assets**. The basic accounting equation is as follows:

Statement Type	Accounting Equation
Old Type - Balance Sheet	Assets = Liabilities + Equity
New Type - Statement of Net Assets	Assets – Liabilities = Net Assets

Statements 34 allows the use of *either a balance sheet type or a statement of net assets method for proprietary or business type activities* such as component units. However, **we propose that component units align to the Statement of Net Assets format, so that we can combine the formats efficiently into the Commonwealth's financial statements.** The Statement of Net Assets format is the methodology preferred by the Commonwealth. The statement of net assets will also have to be *classified* by the segregation of current vs. non-current assets, liabilities and net assets.

A couple of notes about the implementation of the statement of net assets:

⁶ Government Accounting Standards Board Statement 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Accounting*. Paragraphs 20-22. December, 1989.

1. Eliminating entries should be made in the statement of net assets to minimize the “grossing up” effect on assets and liabilities.
2. Internal “Due to’s” and “Due from’s” should also be eliminated. External due to’s and from’s should still be included and should be reported as external transactions, effecting revenue and expense.⁷

What is the difference between current and non-current assets and liabilities?

A current asset or liability is available to be liquidated readily. It has a life of one year or less, or it is one that would be satisfied within the current “cash to cash” cycle. Your statement of net assets must be classified current and non-current in order to comply with Statements 34 and 35. Non-current assets or liabilities are items that will not be satisfied within one year, or one “cash to cash” cycle.

The following are certain classifications of current and non-current items:

Current	Non-Current
Assets	
Cash and short-term investments	Restricted investments
Investments	
Accounts receivable, net	Loans and mortgages receivable, net (over 1 year)
Inventories	Other long – term investments
Assets Held in Trust	Investments in Real Estate
Other assets	Fixed Assets – Land, Buildings, Equipment, Infrastructure, Historical Treasures and artwork net of accumulated depreciation (if applicable)
	Other non-capital assets (e.g. patents etc.)
Liabilities	
Accounts payable and accrued liabilities	Deposits
Deferred Revenues	Long-term Deferred Revenues
Current portion of long term liabilities, bonds, leases, loans and notes (within 1 year)	Long-term portion of long term liabilities, bonds, leases, loans and notes (greater than 1 year)
Claims and Judgements – Current portion	Claims and Judgements – Long Term portion
Current compensated absences and pensions	Long Term compensated absences and pensions

⁷ Statement 34, Paragraphs 59-61.

There may be variants of each category. These variants may be cash related to bond proceeds, cash in reserve funds etc. Please discuss with your external auditor as to these categories' placement as current or non-current.

What are the components of Net Assets and how should they be presented?

The display of net assets should be in three components:

Invested in Capital Assets, net of related debt

Restricted Net Assets – distinguished between major categories of net assets
(Includes un-disbursed bond proceeds for capital projects.)

Unrestricted Net Assets

These components are analogous to what used to be called “fund balance.”

Invested in capital assets, net of related debt

The new category, “Invested in capital assets, net of *related* debt” is a new calculation that will have to be presented in the footnotes, showing how the number was derived. The calculation is as follows:

Cost of Capital Assets Acquired	\$x,xxx,xxx
Less: Accumulated Depreciation	xxx,xxx
Less: Outstanding Debt Related to Capital Assets	<u>x,xxx,xxx</u>
Invested in Capital Assets, Net of Related Debt	<u>\$x,xxx,xxx</u>

This number could potentially report a negative net asset or a net asset of zero. This is due to the fact that debt that is outstanding may exceed the depreciated value of its related assets. In order to obtain this net asset balance, a complete analysis will need to be done, linking your assets to the debt issued to finance them.

If there are unexpended debt proceeds at year-end, the portion of the debt attributable to these proceeds, cannot be counted in the net assets line, “Invested in capital assets, net of related debt.” It should instead be reported **as net assets restricted for capital projects.**

Restricted Net Assets

As indicated above, there could be timing issues that restrict capital assets. Restricted net assets are usually assets limited to designated purposes as per grantor condition. In addition, restriction could likely occur due to creditor or legislative issues. Certain items in the list below may also not be limited to purpose by donor condition. Therefore, some of these may be improperly classified. Each has to be individually evaluated. In your component unit, common restrictions may be the following:

- Escrowed funds for particular purpose
- Loans

- Capital projects
- Debt Service
- Pledged for the specific purpose
- Other

In summation, restricted net assets, as defined in paragraph 34 of Statement 34, should be reported when constraints placed on net asset use are either:

- a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments
- b. Imposed by law through constitutional provisions or enabling legislation.

The basic concept is that restrictions are not unilaterally established by the reporting government itself, and cannot be removed without the consent of those imposing the restrictions or through formal due process.

The definition of *restricted* in paragraph 34 is intended to identify resources that were received or earned by the government with an explicit understanding between the government and the resource providers that the funds would be used for a specific purpose. For example, grants, contributions, and donations are often given under those kinds of conditions. Bond indentures similarly limit the use of proceeds. Therefore, bond proceeds are typically also restricted.⁸

Unrestricted Net Assets are therefore, anything that is left over. Unrestricted net assets are inherently the repository for anything that would otherwise be restricted. The amounts in this category cannot be invested in capital assets, or not restricted in other fashion.

⁸ *Implementation Guide*, Question 95.